The IRS Releases Preliminary Guidance on the IRA Energy Community Bonus Credit

ALERTS

April 6, 2023

On April 4, 2023, the Internal Revenue Service (IRS) released Notice 2023-29 (which follows an earlier notice [Notice 2022-51] released in October 2022 soliciting comments on bonus tax credit requirements, which Wilson Sonsini covered in this alert) regarding certain rules that the U.S. Department of Treasury (Treasury) and the IRS intend to include in forthcoming proposed regulations for determining the qualification for the energy community bonus credit created by the Inflation Reduction Act of 2022 through Sections 45, 45Y, 48, and 48E of the Internal Revenue Code of 1986, as amended (the Code). In short, the energy community bonus credit refers to the 10 percent increased credit amount for a qualified facility, energy project or energy storage technology that is located in or placed in service within an energy community. The notice clarifies what constitutes an "energy community" and when a qualified facility, energy project or energy storage technology is "located in" or "placed in service within" an energy community. The notice states that Treasury and the IRS intend to issue proposed regulations that provide further guidance in line with the notice.

Rules Regarding Project Location

The notice provides that for purposes of the production tax credit (PTC) under Sections 45 and 45Y, the determination regarding a qualified facility's location within an energy community is made on a year-by-year basis during the 10-year credit period. The notice also provides that for purposes of the ITC under Sections 48 and 48E, the determination of a qualified energy project's location is made as of the placed-in-service date.

The notice provides that for purposes of both ITC and PTC facilities, if beginning of construction (BOC) occurs on a facility in a location that qualifies as an energy community, then the facility will continue to be treated as located in an energy community for the duration of the applicable credit period. For this purpose, the notice applies long-standing BOC standards for solar and wind projects: the physical work of a significant nature and 5 percent safe harbor tests. This appears to negate the limitations set forth in the above paragraph.

The notice provides two alternative tests to determine whether a facility is "located in" (for purposes of PTCs) or "placed in service within" (for purposes of ITCs) an "Energy Community Category" as of the applicable testing date. Only one test needs to be met. The Nameplate

Capacity Test provides that 50 percent or more of the facility's nameplate capacity must be in an area that qualifies as an Energy Community Category (e.g., DC or AC capacity for solar facilities or MWh capacity for energy storage devices). This test must be used if the facility's nameplate capacity can be measured. The Footprint Test provides that 50 percent of more of the Facility's square footage is in an area that qualifies as an Energy Community Category. This test can only be used if a nameplate capacity is not available for a facility (e.g., a biogas facility).

Rules Regarding Energy Community Categories

Under the existing provisions of the Code, there are three categories of energy communities: brownfield sites, certain metropolitan statistical areas (MSA), and non-metropolitan statistical areas (non-MSAs) and certain census tracts with closed coal mines or coal-fired power plants (and adjoining tracts).

With respect to brownfield sites, the notice largely reiterates CERCLA-based standards in the Code. The notice also creates a safe harbor for brownfield sites. Essentially, a site meets the definition of a brownfield site if it was previously assessed through federal and certain other resources as a brownfield site, or if an ASTM E 1903 Phase II Environment Site Assessment has been completed with respect to the site and such assessment confirms the presence of a hazardous substance or pollutant or contaminant or, for projects with a nameplate capacity of not greater than 5MW (AC), an ASTM E 1527 Phase I Environment Site Assessment has been completed with respect to the site. While the notice does not explicitly state that the Phase I find contamination, it is implicit that such assessment would confirm the presence of a hazardous substance, pollutant, or contaminant in order to qualify such site as a brownfield. The site must also not fall into the list of sites that are statutorily excluded from the definition.

With respect to MSAs and non-MSAs, the notice provides a list of the delineations of all MSAs and non-MSAs. MSAs are determined in accordance with Office of Management and Budget (OMB) standards (updated every 10 years). Non-MSAs are determined in accordance with Bureau of Labor Statistics (BLS) standards. The notice also incorporates a separate list setting MSAs and non-MSAs that have (or had any time after December 31, 2009) 0.17 percent or greater direct employment related to the extraction, processing, transportation, or storage of coal, oil, or natural gas. The notice provides selected NAICS codes for jobs in the fossil fuel sector, which include oil and gas extraction and drilling, coal mining, pipeline transportation of crude oil and natural gas, petroleum refineries, and certain support activities. Certain NAICS codes, such as those pertaining to oil and gas construction, were omitted. The notice imposes the 2017 NAICS code standard to determine level of employment from fossil fuel industry in MSA or non-MSA. The notice also determines MSAs' and non-MSAs' unemployment rates by using county-specific Local Area Unemployment Statistics published by the BLS and aggregating figures across the counties located in such MSA or non-MSA. This is a helpful use of aggregate calculations instead of a county-by-county determination. The notice states the intent of Treasury and the IRS to publish an annual list of MSAs and non-MSAs satisfying the fossil fuel industry employment standard (taking into account the unemployment standard requirement) each May. As an example, energy communities defined by the 2022 unemployment rates will be designated in May 2023, which designation will apply retroactively to January 1, 2023, and will remain in place until the next update in May 2024. Finally, the notice defers on the question of how to determine fossil fuel tax revenue for MSAs and non-MSAs, noting the challenges in identifying readily available public data tailored to the requirements of the Code and requesting public comments addressing the possible data sources, revenue categories, and procedures to determine whether an MSA or non-MSA qualifies under the Statistical Area Category based on fossil fuel tax revenue.

With respect to coal closure sites, the notice elaborates on the categories of and standards for shuttered coal mines and coal-fired power plants to satisfy this standard. For shuttered coal mines, a closed coal mine includes a coal mine classified as a surface or underground mine that has ever had, for any period of time since December 31, 1999, a mine status of abandoned or abandoned and sealed by the U.S. Department of Labor's Mine Safety and Health Administration (MSHA) in the Mine Data Retrieval System (MDRS). For shuttered coal-fired power plants, the notice provides that a Retired Coal-Fired Electric Generating Unit includes an "electric generating unit" classified as retired at any time since December 31, 2009, by the U.S. Energy Information Administration (EIA) of the U.S. Department of Energy in the Preliminary Monthly Electric Generator Inventory (EIA Form 860M) or the Electric Generator Inventory (EIA Form 860), depending on the year retired. Along with the notice, on April 4, 2023, the Interagency Working Group on Coal & Power Plant Communities & Economic Revitalization released a new "Coal Power Plant Redevelopment Visualization Tool" that allows developers to see coal power plants set to retire alongside key infrastructure characteristics relevant to potential redevelopment opportunities, such as transmission lines and substations. The notice also states that the applicable census tracts for purposes of this category are those used by the Census Bureau for purposes of the 2020 census. The notice states that an eligible directly adjoining census tract to a designated coal closure census tract must directly about the coal closure census tract at least at a single point. Finally, the notice provides a list of census tracts in the Coal Closure Category. In the case of closed coal mines whose location cannot be pinpointed in a census tract (e.g., closed coal mines with listed latitude and longitude coordinates that do not place the mines in a listed county and state), the taxpayer must submit evidence to correct the irregularity in location to MSHA to potentially qualify those areas. In the case of shuttered coal-fired power plants that have irregular locations, taxpayers must submit information to the EIA to address the irregularities to potentially qualify those areas.

Key Takeaways

Clarifying Appropriate Data Sources: Resolves some ambiguities as to the appropriate data sources for determining the applicable Energy Community category, which should make it easier to provide representations as to Energy Community adder availability and resolve some risk allocation questions.

BOC Exemption for PTC Projects: For the Statistical Area category in particular, the BOC safe harbor is a welcome add for PTC projects as developers would otherwise run a prospective year-by-year employment/unemployment risk during each PTC year. However, we note that it appears that if a PTC project is not in an energy community as of the BOC date, but later qualifies due to shifting unemployment figures, then that project would be evaluated on a year-by-year basis for the duration of the credit period for eligibility. We believe that this distinction may come from an intent to ensure that the added incentive for constructing a facility in an energy community is appropriately distributed in the context of PTC projects—that is, in theory, it is more expensive to build a project in an energy community for a host of reasons (lessened ability to procure labor, general economic distress, further distances from load centers, etc.). Accordingly, ensuring that taxpayers who purposefully build projects in energy communities receive the bonus credit for the full 10-year term promotes stability, whereas, if a project was not intended to be sited to receive the bonus credit, but later qualifies due to shifting unemployment figures, that facility will be assessed annually for the bonus credit.

Recordkeeping Requirements: Applies standard Code Section 6001 record-keeping requirements to substantiate a facility is located in or has been placed in service in an applicable Energy Community category.

Draft Energy Communities Map Released: Treasury officials, in conjunction with the Interagency Working Group on Energy Communities, has released a preliminary map where eligible energy community geographical areas can be viewed. That map is available here. We note that this current mapping tool only shows the Coal Closure Category and the Statistical Area Category, and further, that with respect to the Statistical Area Category, the map only shows MSAs and non-MSAs that meet the direct employment related to the above-mentioned NAICS codes, but that only a subset of these MSAs and non-MSAs will actually qualify depending upon whether their unemployment rate for the previous year is at or above the national average unemployment rate. The updated map is expected to be released, according to the website, in May 2023.

Additional Federal Investments in Energy Communities: On April 4, 2023, the White House also announced a series of additional investments in energy communities. This included the Department of Energy announcement that it is making $450 million available to advanced clean energy demonstration projects on current and former mine land. There are currently 17,750 mine land sites. The White House pointed to recent clean energy developments in energy communities, including Berkshire Hathaway's recent groundbreaking for a solar microgrid in West Virginia that will power a new aerospace manufacturing hub on the site of a former aluminum plant, TerraPower's investment in building an advanced nuclear reactor on a retiring coal plant in Wyoming, and Novelis's construction commencement on an advanced aluminum recycling center in Kentucky. The Interagency Working Group on Coal and Power Plant Communities & Economic Revitalization now hosts a website that provides a database of non-dilutive federal award opportunities for clean energy development in energy communities.

Request for Public Comments

Following the request for comments on various provisions of the energy community bonus credit in October 2022, the IRS further requests comments on the possible data sources, revenue categories, and procedures to determine whether an MSA or non-MSA meets the "25 percent or greater local tax revenues" (i.e., fossil fuel tax revenue) requirement. Comments should be submitted by May 4, 2023.

Effective Date

Proposed regulations will apply to taxable years ending after April 4, 2023. The notice states that, until the issuance of the proposed regulations, taxpayers may rely on the rules described in the notice.

Our team would be pleased to assist you in preparation of your comments on issues of particular interest or concern. For more information on issues pertaining to tax and energy and climate solutions, please contact Wilson Sonsini attorneys Nicole Gambino, Hershel Wein, Jaron Goddard, or Brandon King.